

THE EVOLUTION OF PROVINCIAL FINANCE IN BRITISH INDIA
A STUDY IN THE PROVINCIAL DECENTRALISATION OF
IMPERIAL FINANCE

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Dedicated to

HIS HIGHNESS SHRI SAYAJIRAO GAIKAWAD

MAHARAJA OF BARODA

AS A TOKEN OF MY GRATITUDE FOR HIS HELP IN THE
MATTER OF MY EDUCATION

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PART I

PROVINCIAL FINANCE : ITS ORIGIN

CHAPTER I

THE IMPERIAL SYSTEM

ITS GROWTH AND ITS BREAKDOWN

The Imperial system of Government in India dates from the year 1833.

Of the two chief motives which led Parliament to establish it, one was to replace the existing multiplicity in the systems of justice and police by a uniform system of the same, common as far as possible to the whole of India with its varieties classified and systematised. Under the existing system then prevailing such

multiplicity was inevitable, for not only the civil and military government and the ordering and management of the revenues of each of the three Presidencies, Bengal, Madras and Bombay, were vested in their respective Governors in Council, but each Governor in Council was also empowered to make and issue such rules, ordinances and regulations for the good order and civil government of the territories he individually commanded, provided that they were just and reasonable and not repugnant to the laws of the British realm. To the codes of law promulgated by these authorities must be added the whole body of English Statute law introduced in India so far as it was applicable, by the charter of George I in 1726 and such other English Acts subsequent to that date as were expressly extended to particular parts of the country.

The work of administering such a diverse body of laws proved so embarrassing that it was the view of the supreme Court of Calcutta that

" no one person can pronounce an opinion or form a judgement... upon any disputed right of persons, respecting which doubt and confusion may not be raised by those who may choose to call it in question; for very few of the public or persons in office at home, not even the Law Officers, can be expected to have so comprehensive and clear a view of the Indian system of law, as to know readily and familiarly the bearings of each part of it on the rest."

The other motive was to create a strong central government to deal effectively with the European settlers in the country. It is to be noted that if the native population suffered under the uncertainties of law, the British population lived under the most galling restrictions. The revelations of oppressions by Englishmen practised, in the early days of British Rule, contained in the report of the Secret Committee of the House of Commons appointed in 1771 to inquire into the affairs of the East India Company, were followed by very stringent laws governing the entry and residence of private British subjects in India. No British subject of European birth was allowed to reside in India beyond 10 miles from any one of the principal settlements without having previously obtained a special license from the Company or the Governor-General of India or the Governor of the principal settlement in question. The Court of Directors of the Company, subject to revision of the Board of Control were empowered to refuse such licenses and the Governments in India were strictly enjoined not to sanction the residence of British subjects on their own authorities except under special circumstances and were authorised, in cases they deemed proper, to declare licenses otherwise valid as void. Counterfeiting licenses and unlicensed residence were made crimes punishable with fine or imprisonment; and persons who were dismissed from, and who had resigned service, were declared guilty of illicit trade if they lingered beyond the 10-mile limit after their time had expired: Unlicensed British subjects were made liable to be deported and such as were licensed were required to register themselves in the court of the district in which they resided.

Subjected as they were to the regulations of the Local Government they were made amenable to justice in India as well as in Great Britain for all illegal acts done in British India, or in Native States. To render them impotent to cause complications, they were not allowed to lend money to or be concerned in raising any for native princes or foreign companies or foreign European merchants. Similarly to protect the natives from their oppression they were forbidden to lend money to the latter at a rate of interest exceeding 12 per cent. per annum on penalty of forfeiting for every offence treble the value and they were placed under the jurisdiction of the Justices of the Peace in all cases involving assault or trespass on, and small debts due to, the natives of India. Moreover, every British subject of European birth was required to register in the office of his district the name, etc., of his native stewards, agents, and partners, on penalty of being disentitled to recover or receive any sum or sums of money by reason of the joint concern or to compel an account thereof by any suit in law or equity in any court within the provinces.

The ruling race had long chafed at these restrictions, under which it was placed, without much avail. They were evidently aimed at keeping out an element dangerous to the stability of the Indian Empire, but, as time went on, and as the Indian Empire was consolidated by successive victories over the native princes, there was raised against these restrictions such a storm of indignant criticism that even those who had acquiesced in their virtue were forced to admit that they had outlived their purpose. While the British Parliament could not help abiding by the sentiments of the time, it refused to disregard the consequences which it thought would inevitably attend upon the free ingress of British subjects of European birth under the then existing system of government. It realised that a harmonious treatment of the immigrants and an effective control over them was absolutely essential. Parliament was afraid that the different governments armed as they were with co-equal and independent powers of legislation and administration by exercising these powers with regard to the immigrants entering their respective territories, with different views and according to inconsistent principles might integrate the whole mass of them into a disaffected body difficult to be dealt with. Besides the necessity of a harmonious treatment based on uniform principles, the fears of Parliament that the ingress of British immigrants would result in the revival of oppression on the natives were not completely allayed. As its recrudescence was felt to be a likely event, Parliament desired to subject them to a strong and uniform central control, so that the offender in one jurisdiction might not be able to find an asylum in another. Thus, whether considered from the standpoint of bringing about uniformity of laws or securing stringency of control over elements subversive of order, the then existing system of government with its divided jurisdiction was ill-suited for the purpose held in view. An all-powerful Central Government legislating for and controlling the affairs of India as a whole

was deemed to be the only solution for the emergency.

Accordingly there came to be enacted in 1833 that

" the Governor-General in Council (at Fort William in Bengal) shall have power to make laws and regulations for repealing, amending, or altering any laws or regulations, whatever, now in force or hereafter to be in force in the said territories or any part thereof, and to make laws and regulations for all persons, whether British or native, foreigners or others, and for all Courts of Justice, whether established by His Majesty's Charters or otherwise and the jurisdictions thereof, and for all places and every part of the said territory, and for all servants of the said Company within the dominions of princes and states in alliance with the said Company. . . . ;

A Central government was thus created by vesting the legislative power exclusively in the Governor-General of India in council. But it could not have been all-powerful had the two Presidencies of Madras and Bombay remained as heretofore invested, by law, with the civil and military government of their respective territories. On the other hand, if Parliament had stopped short of divesting them, there would have ensued the possibility of a conflict between these governing authorities and the sole legislative authority newly created. Being responsible for peace, order and good government, the former could have refused to govern according to laws made by the latter, and all the gain expected to arise from the institution of a central and strong government would have been lost. To eliminate this element of weakness in the Indian politics newly established, Parliament proceeded to divest the presidencies of Bombay and Madras of the high status which they hitherto occupied as *responsible* governments, so that according to the new Constitution

".....the Executive Government of each of the several Presidencies (was to be) *administered by* (not vested in as heretofore) a Governor and three Councillors "

While

".....the Superintendence, Direction, and Control of the whole civil and military government of all the..... territories and Revenues in India (was) vested in a Governor General and councillors styled the Governor-General of India in Council."

Thus came to be established in India the Imperial system of government. It is true that long before its establishment the Government of Bengal had the supreme power, not only of superintending and controlling the government and management of the Presidencies of Madras and Bombay in the matter of commencing hostilities, or declaring or making war against any Indian prince or power, or for negotiating or concluding any treaty of peace or other treaty with them, except in case of emergency, but it also possessed by a later enactment the power of superintendence in all such points as related to the collection or

application of revenues, or to the forces employed, or to the civil or military government of the said presidencies. But it must not be supposed, as is often done, that before 1833 the two Presidencies were in any real sense subordinate to Bengal in their domestic affairs. The fact that Madras and Bombay were required constantly and diligently to transmit to the Government of Bengal true and exact copies of all orders and resolutions and their acts in Council, and were enjoined to pay due obedience to the orders of the Government of Bengal, must not be construed to mean any subordination in their internal affairs. For, barring the extra territorial authority vested in the Government of Bengal, it must be borne in mind that, equally with Bengal the Governments of Madras and Bombay were *vested each* with the civil and military government and also with the ordering and management of all territorial acquisitions and their revenues. Along with the Government of Bengal they possessed as stated before co-equal and independent powers of legislation within their respective jurisdictions. A truer view therefore seems to be that they forwarded the copies of their proceedings to the Government of Bengal for information rather than for orders. At any rate, such seems to have been the view taken by the Government of Bengal itself, for, though it had the power to issue orders and compel obedience to them it had in practice confined its supervision and control " to pointing out an irregularity and requesting that it be not repeated." More than this was thought inadvisable and it is doubtful whether it would have been constitutional.

The Imperial system of Government was necessarily accompanied by the Imperial system of Finance. Before the inauguration of the Imperial system of Administration the several Presidencies were like separate clocks each with its own mainspring in itself. Each possessed the powers of sovereignty, such as the legislative, the penal, and the taxing powers. They were independent in their finance. Each was responsible for the maintenance of services essential for peace, order and good government within its jurisdiction and was free to find money by altering or levying taxation or borrowing on credit to meet its obligations. For their ways and means they often drew upon the resources of one another, not, however, because their exchequers were not distinct, but because they were parts of a common exchequer belonging to the East India Company. All this was changed by the Act of 1833, which vested the revenues and the government of the different territories in the Governor-general of India in council. The revenues and the services became by law the revenues and the services of the Government of India. The provinces became the collecting and the spending agencies of the Government of India. They ceased to levy any new taxes or to collect the old ones in their own name. In like manner the services they administered became a charge of the Government of India, which distributed among the various provinces sums from the consolidated fund for the maintenance of the services. It was by law provided that without the previous

sanction of the Government of India the provinces were not to spend the fund allowed to them in creating any new office or granting any salary, gratuity, or allowance. The public debt was no longer a charge upon the revenues of any particular Presidency alone, nor did there remain any question of primary or secondary liability as between the revenues of the other Presidencies. All the provincial debts became the debts of the Government of India and were charged to the revenues of India as a whole. In short, the financial system which was roughly analogous to the system of separation of sources and contributions from the yield was changed into a system of aggregation of sources and distribution of the yield; for, as observed in a Government Resolution by virtue of the Act of 1833,

" British India, though for the sake of convenience subdivided into Presidencies under separate locally controlled governments, (became) in reality one sole grand Power in dependence on Great Britain, having undivided interests, a single exchequer, and controlled in all essential and general principles by one Government—the Governor- General in Council..... The entire resources of India (were) applicable to one purpose only, the discharge of its engagements and those connected with its management in England, and to whatever section of British India funds (were) wanting, funds (were) supplied, as a matter of course, without any reference to the particular source from which they were derived. So comprehensive did the system of Imperial Finance become in time that when in 1858 the Crown took over from the Company the government of India it was found that

" no province had any separate power of legislation, any separate financial resources, or practically any power of creating or modifying any appointments in the public service; and the references to the Government of India which this last restriction involved gave that Government the opportunity of interference with all the details of provincial administration"

Whatever may have been the merits of the Imperial system of Government from the military, political, legislative, or administrative points of view, it is a melancholy fact that as a system of finance it proved unequal to the strain imposed upon it. From its very start it suffered from the fatal disease of financial inadequacy, and it was only occasionally that the efforts of the Finance Ministers were successful in restoring an equilibrium and slaving off the hour of crisis. How chronic the deficits were may be seen from the following 'figures :—

YEAR	SURPLUS	DEFICIT	YEAR	SURPLUS	DEFICIT
1834-35		194,477	1846-47		971,322
1835-36	1,441,513		47_48		1,911,986
1836-37	1,248,224		48_49		1,473,225
1837-38	780,318		49_50	354,187	
1838-39		381,787	50_51	415,443	

1839-40		2,138,713	51_52	531,265	
1840-41		1,754,852	52_53	424,257	
1841-42		1,771,603	53_54		2,044,117
1842-43		1,346,011	54_55		1,707,364
1843-44		1,440,259	55_56		972,791
1844-45		743,893	56_57		143,597
1845-46		1,496,865	57_58		7,864,222

Anyone who ponders upon this pitiable story of Indian Finance as revealed by these deficits can hardly fail to wonder with Disraeli who remarked in the House of Commons that—

"able as has ever been the administration of India, considerable and distinguished as have been the men whom that administration had produced, and numerous as have been the great Captains, the clever diplomatists, and able administrators of large districts with whom the Government has abounded, the state of the finances of India has always been involved in perplexity, and India that has produced so many great men, seems never to have produced a Chancellor of the Exchequer."

The causes of this collapse, however, are not far to seek. The inadequacy of Indian Finances is mainly to be ascribed to an unsound fiscal policy. The policy was unsound for various reasons. In matters of state economy it is usual to argue that the expenditure to be incurred should determine the magnitude of revenue to be raised. But experience has shown that this stock maxim has proved ruinous wherever its limitations have failed to receive their due weight. It cannot be too often said that the growing expenditure of the State can only be sustained from the growing wealth of the society. Nor can it be too strongly emphasised that the test of sound finance does not merely consist in being capable of raising the requisite amount of revenue. It must be remembered that the *mode* of raising the revenue is an aspect of the question which is fraught with tremendous consequences for the stability and productivity of the nation. It is too obvious to be denied that a tax system by its unequal incidence may cause social upheavals, just as by its unwise incidence on trade and industry it may impoverish society by setting out of gear its economic mechanism and technique and eventually beggar the State by impairing the productive powers of society. Wisdom therefore requires that those who are entrusted with the financial management of the State should look beyond the more immediate object of raising and spending of money, for the "hows" of finance are very important, and can be seldom neglected in practice with impunity. The wealth of society is the only patrimony on which the State can draw, and the State that damages it cannot but end in damning itself History abounds with instances of States wrecked by the unwise neglect of these evident truths, but if an illustration be

wanted in further proof thereof, the system of Imperial Finance established in India is matchless for the purpose.

The land tax was the heaviest impost of the Imperial revenue system in operation. The underlying doctrine of the tax in India has been that it is of the nature of rent paid by the cultivator to the State in virtue of the theory that the land in India has from immemorial times been regarded as the property owned by the State. The cultivator is not the proprietor, but is the occupier of the land. The land is let to him and the State is therefore justified in claiming the whole of the economic rent arising from the land. On this assumption the land tax has been imposed irrespective of the question of necessity or justice.

Besides this legal fiction of State landlordism there was also another economic principle, which was, taken to be the justification for the enhancement of the land revenue. There is reason to believe that the Physiocratic doctrine of *produit net* had its influence in the management and fixing of the land tax in India. We find high officials in India arguing in the early stages of the revenue management that "whether or not the principle of the French Economists of laying all the taxes on the land be..... erroneous or otherwise, it is certainly conformable to the prevalent system in India; nor is that theory supported by the French alone, but by respectable authorities in England, who contend that all taxes fall ultimately on the products of the soil, and that in advancing a different doctrine the eminent author of *The Wealth of Nations* is at variance with himself, inasmuch as his previous data lead to that conclusion."[\(this footnote is given below\)](#) Whatever may have been the reasons for augmenting the land tax, few can deny that a heavy consolidated impost on the first exertions of any species of industry absorbing the whole or nearly the whole of its profits in ruinous and impolitic. It becomes an effectual bar to the creation of that produce on which the future exertions might be profitably employed and through the medium of which individual wealth and public revenue may be increased to an almost inconceivable extent. A land tax of this nature was sure to blast the very production of that wealth which industry would have otherwise brought into being. the land tax was so heavy that the system of tax prevailing in India might well have been called a near approach to the single tax system. Page: 8

The ratio of the land revenue to the total revenues of India was as given below :—

Year	Ratio	Year	Ratio	Year	Ratio
1792-93 to 1796-97	50.33	1817-18 to 1821-22	66.17	1842-43 to 1846-47	55.85
1797-98 to 1801-02	42.02	1822-23 to 1826-27	61.83	1847-48 to 1851-52	56.06
1802-03 to 1806-07	31.99	1827-28 to 1831-32	60.90	1852-53 to 1855-56	55.40
1807-08 to 1811 -12	31.68	1832-33 to 1836-37	57.00	Average for 64 years	54.07
1812-13 to 1816-17	53.33	1837-38 to 1841-42	59.05		

While the land tax prevented the prosperity of the agricultural industry the customs taxes hampered the manufactures of the country. There were internal customs and external customs, and both were equally injurious to trade and industry. The internal customs were made up of transit and town duties. For the purposes of transit duties the country was artificially divided into a number of small customs areas. Goods may be manufactured and consumed *ad libitum* within each customs area, but the moment they left their own division they became liable to duty. The injurious effects of this regulation, though concealed, were none the less real. The transit duties held up trade, which in its turn reacted adversely on the manufacturers of the country. Adam Smith has told us how the growth of industry depends upon the extent of the market. Here for the purposes of the transit duties the whole country was cut up into small bits after the manner of squares on a chess board. What wonder is there if trade, and its handmaid, industry, both languished to a serious extent. The adverse effect on the transit duties was also felt in another way. In every country somewhat industrially advanced there is not only a social division of labour, but there is also a territorial division of labour, otherwise called localisation of industry. Evidence is not wanting to show that the localisation of industry formed a prominent feature of Indian economy. Under it each locality in India specialised in a particular art or industry; for instance, cotton was grown in one locality, woven in another, and bleached in a third place. But it often happened that these localities were situated in different customs areas, and a raw good might have had to pay the transit duty many a time before it reached its finished stage. To avoid this each locality was obliged to waste its energies along unprofitable lines in order to escape the transit duties.

The town duties, which formed a part of the internal customs, also worked in their effects towards de-urbanisation. Commercial entrepots are admittedly vast instruments of the trade of a country. The opportunity of ready purchase and sale of almost every kind of commodity in any quantity, accumulated capital, extended credit, general information all meet here as in a centre. They support, encourage and give lift to commerce and to the trade of a country. But the direct effect of the town duty was to distract and drive away trade, for under the system every article which was subject to it had, after the payment of transit duty, to pay on entry, in the town, the town duty and, if it underwent any change of form by manufacture within the town of entry, it could not have been furnished to any neighbouring place without a second impost being paid upon it under the transit duty system, enhanced in proportion to the increase of value it might have acquired from the labour and the skill bestowed upon it, The consequence was that towns dwindled both in trade and industry owing to the reason that merchants ceased to frequent them and that no manufactures of articles subject to the transit duty were capable of being established in them except for their own supply.

It was in this depressed condition that the Indian industries were called upon to meet foreign competitors. But the external customs cannot be said to have protected, much less fostered them. As a rule commercial tariffs are based upon what is called commodity competition. The import tariffs are designed to check by means of higher duties the importation of such foreign commodities as are likely to interfere in the successful manufacture of the same commodities at home and the export tariffs are framed principally with a view to give bounties to such of the home commodities as have a chance of securing a foothold in foreign markets. But the theory of external customs in India had no connection with the theory of commodity competition. In comparison with the policy actually adopted even a protectionist would have preferred to see trade left perfectly free, for the tariff was based on political rather than economic considerations. The Indian Import Tariff varied not with the nature of the imports but with the origin of the imports and the bottom on which they were shipped. Being political in character it was preferential in design and in its framework. It is to be regretted all the more that the preference involved an unmitigated loss to the people and to the government. It was excusable to have admitted into India goods of English origin and shipped on English bottoms at a rate half of what goods of foreign origin and shipped on foreign bottoms were charged with. But nothing can extenuate the sacrifice imposed upon the Indian industries by letting in British goods at lower rates than what the Indian goods had to pay under the internal customs; and this was done when, be it remembered, England was prohibiting by high tariff the entry of India-made goods and India-built ships! But while the import tariff made it easy for the foreigners to compete successfully with Indian manufactures burdened as they heavily were by the weight of the internal customs, Indian goods found it considerably difficult to compete in foreign markets under the incubus of export duties which formed one of the most lamentable features of the Indian tariff and which endured long into the nineteenth century. Thus the customs laws internal and external blockaded trade and smothered industry. The comparatively paltry revenues derived from them is the best proof of their ruinous effects.

The following table gives the ratio of the Customs Revenue to the total revenue :—

Year	Ratio	Year	Ratio	Year	Ratio
1792-93 to 1796-97	2.38	1817-18 to 1821-22	8.32	1842-43 to 1846-47	6.02
1797-98 to 1801-02	3.10	1822-23 to 1826-27	7.58	1847-48 to 1851-52	5.40
1802-03 to 1806-07	4.16	1827-28 to 1831-32	8.12	1852-53 to 1855-56	5.52
1807-08 to 1811-12	5.04	1832-33 to 1836-37	7.19	Average for 64 years	6.22
1812-13 to 1816-17	6.68	1837-38 to 1841-42	6.76		

Hendricks, op. cit., p. 286.

When these resources failed the Government resorted to some very

questionable means of raising revenue.

On an impartial survey of the revenue system as prevailed under the Imperial regime one is constrained to say that justice in taxation was conspicuous by its absence. It was a cruel satire, or at best an idle maxim, for the lancet was directed not where the blood was thickest but to that part of the body politic which on account of its weakness and poverty most meekly bore the pang. The landlords who passed their lives in conspicuous consumption and vicarious leisure on the earnings of the poor tenants, or the many European civil servants who fattened themselves on pay and pickings, were supremely exempted from any contribution towards the maintenance of the Government whose main activities were directed towards the maintenance of pomp and privilege. On the other hand, the salt tax# and the Moturpha, and other oppressive taxes continued to harass the industrious poor.

#The percentage ratio of the salt revenue to the total revenue at different times was as follows:—

Year	Ratio	Year	Ratio	Year	Ratio
1792-93 to 1796-97	14.13	1817-18 to 1821-22	11.25	1842-43 to 18 46-47	11.65
1797-98 to 1801-02	12.10	1822-23 to 1826-27	11.87	1847-48 to 1851-52	9.14
1802-03 to 1806-07	11.09	1827-28 to 1831-32	12.03	1852-53 to 1855-56	9.17
1807-08 to 1811 -12	11.14	1832-33 to 1836-37	9.72	Average for 64 years	11.07
1812-13 to 1816-17	10.92	1837-38 to 1841-42	12.37		

Hendricks, *op. cit.*, p. 283.

It is indeed true that many petty and vexatious taxes prevalent under the native rule were abolished; there is, however, enough evidence to show that the revenue thus lost was made up by enhancing those that were continued to be levied, particularly the land tax. The latter charge has always been officially denied, but none the less it remains true that the land tax has been consolidated and increased concurrently with, if not consequently upon, the abolition of such other taxes as being raised from the poor cost the Government more than their yield.

Under the injurious revenue system described above, the taxing capacity of the people decayed so that notwithstanding its numerous resources# from which it derived its revenues the Imperial Government was unable to make both ends meet.

#The following is a conspectus of the taxes levied :—

Source of Revenue	Amount of Revenue raised in Millions	Period		Locality and Date of Commencement
		No. of Years	Dates	
Land Revenue	662.308	64	1792-93 to 1855-56	Throughout the period in Bengal, Bombay and Madras since 1834-5 in

				N.W.P. and 1849-50 in the Punjab.
Sekyer & Abkary	9.729	20	1836-37 to 1855-56	Throughout the period in Bengal, N.W.P., Madras and Bombay, and since 1849-50 in Punjab.
Excise	4.987	„	„	Bengal accounts exclusively.
Moturpha	6.455	„	„	Madras accounts exclusively.
Salt	135.532	64	1792-93 to 1855-56	Bengal since 1792, Madras 1822, Bombay 1822, N.W.P. 1839.
Opium	106.707	„	„	Bengal since 1792, Bombay since 1820.
Post Office	8.888	„	„	Bengal and Madras since 1792, Bombay since 1813, Punjab 1849, N.W.P. 1835.
Stamps	16.697	59	1797-98 to 1855-56	Bengal from 1797, Madras from 1813, Bombay from 1819, N.W.P. from 1834, Punjab from 1849.
Customs Duties				
Internal 1. Transit 2. Town External 1. Import 2. Export	76.179	64	1792-3 to 1855-56	Bengal, Madras and Bombay from 1792-3, N.W.P. from 1834-5, Punjab since 1849-50.
Mint	3.221	„	„	Bengal from 1792, Madras and Bombay from 1813.
Revenue Tobacco	1.437	18	1836-37 to 1853-54	Madras 1836 on.
Miscellaneous	194.777	64	1792-93 to 1855-56	Same as under land revenue.

It ought to serve as an object lesson to all financiers to show that when their revenue laws are harmful to the resources of the people they must blame none but themselves for their empty treasury.

Was the money raised by such injurious taxes without reference to their effect on the productive powers of the country spent on such public utilities as were calculated to enrich and elevate the economic life of the tax-paying population ? A glance at the following table giving the distribution of the expenditure by decades on the different services will show how the money was spent:—

Distribution of the Expenditure*

Percentage Ratio of Total Expenditure on	in the Year					
	1809-	1819-	1829-30	1839-40	1849-50	1857

	10	20				
Military	58.877	64.290	53.754	57.721	51.662	45.55
Interest on debt	18.010	12.805	12.124	9.756	10.512	7.19
Civil and Political	7.221	8.900	9.575	12.296	8.902	9.62
Judicial	7.525	6.800	7.107	9.565	7.180	}
Provincial Police	1.991	2.093	1.535	2.062	2.062	} 9.38
Buildings, Fortifications, etc.	1.639	1.756	2.810	1.428	1.661	

Prominent among this array of figures are those on the military expenditure and though they have dwindled in years they have invariably consumed more than one half of the total revenues of the country. But the stupendous figures opposite military do not represent the true burden of that expenditure. To them must be added the figures for the interest charge on debt, for the debt incurred was entirely a war debt. India was all throughout this period a battle-ground between the Country Powers and the East India Company. The two Mahratta Wars, the three Mysore Wars, the two Burmese Wars, the two Afghan Wars, and the Carnatic Wars, not to speak of the numerous other minor engagements, were fought in the interests of adding India to the dominions of the Company and of the Crown. While Parliament claimed that the dominions of the East India Company were the dominions of the Crown it must be borne in mind that it refused to pay a farthing of the purchase money. On the other hand, the entire cost of these wars was borne by India as so much dead weight on her scanty resources. The charges shown separately under buildings and fortifications must also be included in the military expenditure, to which category they really belonged. On making these needful additions we find the unparalleled fact of a country wasting between 52 to 80 per cent. of its precious little money on war services. It may, perhaps be argued on the other hand that much of the military expenditure, large though it was, went back into the coffers of the Indians themselves as they formed the bulk of the forces employed in the country. The Indians of course, formed a very large portion of the military# and if the scales of salaries fixed for the European and native forces were equal the result would have been favourable to the natives of the country, though it cannot be said to have excused that huge military expenditure.

#This may be seen from the following figures :—

STRENGTH OF THE INDIAN ARMY BEFORE THE MUTINY*

	European	Native	Total
Artillery	6,419	9,138	15,577
Sappers	110	3,043	3,153
Cavalry	3,456	30,533	32,989
Infantry	29,760	188,660	218,420
Total ...	38,745	231,374	270,119

* Report of Major-General Hancock on the Reorganisation of the Indian Army, Parliamentary paper of the year 1859, p. 21.

2 But the scales of salaries for the Europeans and natives were so grossly unequal# that one European drew on an average more than the salaries of four natives put together.

3 #This is indicated by the following table :—

COST OF AN INFANTRY REGIMENT PER MONTH

EUROPEAN						
	Details			Total		
	Rs.	As.	Ps.	Rs.	As.	Ps.
<i>Officers</i>						
37 Officers	14,734	14	3	21,779	2	7
Staff and Establishment	4,515	12	4			
Command and other allowances	2,528	8	0			
<i>Men</i>				25,999	8	0
117N.C.O.S.	2,289	4	5			
950 Privates	11,203	8	4			
Rations, clothing and other charges Total	12,506	11	3			
				47,778	10	7

So this expenditure, whether from the standpoint of public utility or private employment, did not benefit the population which contributed to the revenues of the State.

The civil and political charges which absorbed nearly 10 per cent. of the revenue can hardly be said to be recuperative in their effect. This part of the expenditure again was not shared by the native population which bore its burden. As a result of conquest the natives naturally came to occupy a secondary position; but the conquest had done more than merely degrade their status. It had engendered a certain sense of distrust for the natives in the minds of Englishmen. Conquered and distrusted the natives since the commencement of British rule had come to be excluded from the higher administrative posts of the country#.

#Before 1833 the very meagre scale on which they were employed is disclosed by the following figures :—

Native Civil Servants of the 1st Class attached to the Secretariat of the 3 Presidencies Receiving per Month Salaries of Rs.	Bengal		Madras		Bombay		Total	
	No.	Total Salary Drawn	No.	Total Salary Drawn	No.	Total Salary Drawn	No.	Total Salary Drawn
500 and upwards	5	2,700			5	2,500		
400 and upwards	2	800			1	400		

350 and upwards	4	1,400	1	350	1	350		
300 and upwards	3	900			2	600		
250 and upwards	5	1,250			1	250	89	20,690
From Rs. 250 to 200	17	3,460	5	1,155	1	200		
From Rs, 200 to 150	10	1,590	4	682 1/2				
From Rs. 100 to 150	5	550	5	525	5	330		
Below Rs. 100	6	470	1	871/2	2	140		
Total	57	13,120	16	2,800	16	4,770		

It was to remove this injustice that Parliament in the Act of 1833 provided "that no native of the said territories, nor any natural-born subject of His Majesty resident therein, shall, by reason only of his religion, place of birth, descent, colour or any of them be disabled from holding any place, office, or employment under the said Company " (sec. 87).

NATIVE						
	Details			Total		
	Rs.	As.	Ps.	Rs.	As.	Ps.
<i>Officers</i>						
26 Europeans	9,861	2	1			
20 Natives	940	0	0	13,527	8	7
Staff and	1,209	1	4			
Establishment Command and	1,517	5	2			
other allowances	1,780	0	0			
Men	7,000	0	0	9,606	14	0
140 N.C.O.s.	826	14	0			
1,000 Sepoys						
Charges						
Total				23,134	6	7

It is evident from this table that if we deduct the salary of 26 European officers and command and other allowances shown under the heading " Native " which amounts to Rs. 11,378 7. 3. we shall find that 1,104 Europeans drew Rs. 47,778 10. 7. while 1,160 natives drew only Rs. 11,755 15. 4.

But, as a matter of fact, till after the Mutiny not one of the natives was appointed to any office except such as they were eligible for before this Statute was passed, because the Court of Directors in interpreting it advised the Government of India at the very start that by this enactment

"practically..... no very marked difference of results will be occasioned. The

The Judicial and police charges, which together absorbed something like 10 per cent. of the total revenue raised, can only be regarded as protective in their

distinction between the situations allotted to the covenanted service and all other situations of any official or public nature will remain generally as at present." character. Thus the bulk of the money raised by injurious taxes was spent in unproductive ways. The agencies of war were cultivated in the name of peace, and they adsorbed so much of the total funds that nothing practically was left for the agencies of progress. Education formed no part of the expenditure incurred and useful public works were lamentably few. Railways, canals for navigation or irrigation and other aids to the development of commerce and industry for a long time found no corner in the Imperial budget. For a total area of 837,000 square miles there were constructed a few miles of railways, 2,157 miles of land ways, 580 miles of waterways and 80 miles of telegraph. Or speaking in terms of money spent, we find that for the entire period of fifteen years from 1837-8 to 1851-2 the average expenditure of a productive character amounted only to £ 299,732 a year. There is a principle well known to farmers that constant cropping without manuring ends in the exhaustion of the soil. It is, however, capable of wider application, and had it been observed in the State economy of India the taxing capacity of the country would have grown to the benefit of the treasury and the people. Unfortunately it was lost upon the financiers of India to the detriment of both.

But if the chance of augmenting the resources by judicious taxes and productive expenditure to cover the chronic deficits was forfeited, there was at least the way open for economy in expenditure. As might be supposed, a strong Central Government of the kind established in 1833 was capable of effecting economy wherever possible. As a matter of fact, the centralisation was of the weakest kind. *De jure* there was an Imperial system of administration, but the *de facto* administration was conducted as though the primary units of executive government were the Provinces and that the Government of India was only a co-ordinating authority. This was obvious from a variety of circumstances. Legislation was, it is true, centred in the Government of India; none the less the laws that were passed by the Government of India were passed *for* the different provinces as though the initiative in legislation still lay in the Provinces and that the Government of India was only a sanctioning authority. Each Province had its own customs, internal as well as external, a survival of their sovereign status. Each Province continued to have its own Army. Notwithstanding centralisation, the account system still remained provincial, sustaining the sense of their financial independence. The work of administration and collection of revenue being still conducted by them, the provinces behaved as though they were the lawful authorities charged with the responsibilities of Government. This spirit of independence bred insubordination, and some of the Provinces, particularly Bombay and Madras, endeavoured to resist the attempts of the Government of India to tax the people under their jurisdiction when the cost of the mutiny

compelled it to levy fresh burdens. The point to be borne in mind is that the Act of 1833 made an unfortunate divorce between the legal and administrative responsibility. The Imperial Government were responsible in law but did not administer the country. The Provincial Governments administered the country but had no responsibility in law. This divorce had a fatal effect on the economy in the finances of the country. As was inevitable extravagance in expenditure had become the rule in practice and it was inherent in the Imperial system itself. Economy is begotten of responsibility, and responsibility is obtained where a government has to *find* the resources to meet the charges it desires to incur. Prior to the inauguration of the Imperial system the Provincial Government had the obligation to raise money for the charges included in their budgets. Consequently they had to be economical.

But under the Imperial system, while the budgets for the various services were prepared by the provincial authorities, the responsibility for finding the ways and means rested on the Government of India. Formerly "They knew the limits of the purse they had to draw upon, but under the Imperial system they

" had no means of knowing the measure by which their annual demands upon the Government of India ought to be regulated. They had a purse to draw upon of unlimited because of unknown depth. They saw on every side the necessity for improvements, and their constant and justifiable desire was to obtain for their own provinces as large a share as they could persuade the Government of India to give them out of the general revenues of the Empire. They found by experience that the less economy they practised and the more importunate their demands, the more likely they were to persuade the Government of India of their requirements. In representing these requirements, they felt that they did what was right, and they left to the Government of India, which had taken upon itself, the responsibility of refusing to provide the necessary means".

To these extravagant demands the Government of India had often to yield; for, till very late, it did not possess the machinery to appraise the demands and to control the expenditure on them. It is not usual to expect much efficiency from any Imperial system of administration, much less when it covers not a department, not a province, but a country as big as a continent. Merely from being huge it is slow to move. Much slower would it necessarily be if it were a system as unorganised and unconsolidated as the Indian system was. First of all, the Imperial system in India was without its executive machinery of control. The Act which created it must be said to have grievously erred in uniting into one the Government of Bengal and the Government of India. As a result of this fusion the machinery was over stained. Its duties as the Government of Bengal left it very little time to attend to its duties as the Government of India. There was not only a common executive, but there was also a common Secretariat charged with the work of the two Governments. Overworked as the Secretariat was, its efficiency

was considerably lowered by the absence of any officer specially charged with the duty of handling the finance of the country till 1843.

It was in that year that Lord Ellenborough, the then Viceroy of India, separated the Secretariat of Bengal from that of India and attached to the latter a distinct office called the Financial Secretary to the Government of India unencumbered with the details of any other Department of State except that of finance. But while the want of a scrutinising officer was thus made good by this appointment of a distinct Secretary of Finance, it was not possible for him to enforce economy in expenditure in the absence of a centralised system of audit and account and of an appropriation budget. Notwithstanding the establishment of the Imperial system of finance, the officers of audit and account remained attached to the Secretariats of the various Provincial Governments. They were not accountable to the supreme Government on whom the responsibility for the ordering and the management of the revenues of India had by law devolved. Being attached to the provincial Secretariat the Government of India could issue orders with regard to the accounts and the audits not directly but only through, and with the interpretation of, the Local Government concerned. Secondly, the budget system, though good enough for the purposes of mercantile accounts, that is, record, was useless for the first and elementary purpose of all good State accounts, namely, check. There were indeed three estimates (sketch, regular, and budget) prepared for the purposes of the financial administration of the country showing the amount of money required for the carrying on of each of the different services. But this distribution of public money on the different services was not held to mean appropriation. It was only treated as cash requirements. Owing to this fact the grants were never carefully prepared nor was the limit set on them observed in practice. As there was no budget of specific votes or sanctions for each of the services the audit and account was simply concerned with noting whether record was kept of all the money that was received and paid through the public treasury. It is evident that in the absence of an appropriation budget the primary object of all State accounts and audit, namely check on the spending authority to abide by the sanction, was never achieved. The Provincial Governments, extravagant in their demands, were also careless in the matter of expenditure. So long as the Government of India remained without an appropriation budget and a centralised system of audit and account, it continued to be only a titular authority in the matter of financial control, and the provinces, though by law the weakest of authorities in financial matters, were really the masters of the situation.

To its inability to curb the extravagant habits of the provincial authorities generated by a financial irresponsibility on the part of the Provincial Governments and inefficiency on the part of the Central Government must be added the general spirit of apathy which marked the Executive Council of the Government of India in matters of finance. While it was true that nothing could be spent from

the revenues of India without the specific vote of the Executive Council, it does not appear that the Council from its way of working could have taken any keen interest in promoting economy in expenditure. The Council acted collectively, and there was no distribution of executive work among the different members which composed it. With the exception of the Department of War and Legislation the whole work of the Government was brought before the Governor-General and his Councillors. As a result of its collective working

" every case actually passed through the hands of each member of the Council, circulating at a snail's pace in little mahogany boxes from one Councillor's house to another."

Under such a system nobody was a Chancellor of the Exchequer to urge economy, because everybody was supposed to be one. The result was that finance in being everybody's business suffered from being nobody's business, so that funds were distributed not according to the genuine needs of the services, but according to the relative claims and persistency of the clamour made for them.

Sufficient evidence has been given to show that the collapse of the Imperial system was due to a faulty fiscal system marked by injurious taxes and unproductive and extravagant expenditure. It must not, however, be supposed that this faulty fiscal policy commenced with the inauguration of the Imperial system. On the other hand, it was a heritage which descended to the Imperial system from the past. None the less it is obvious that a timely revision of the fiscal policy and the strengthening of central control would have solidified the foundation of the Imperial system. But a much too long continuance thereof undermined its financial foundations, and as it could get no more money to meet its rising expenditure from a people whom it had beggared, the Imperial system succumbed to the shock of the Mutiny, never to rise again in its original garb.

CHAPTER II

IMPERIALISM V. FEDERALISM

As the result of the cost of the Mutiny of 1857 the already precarious condition of the Imperial Finance became so grave that no problem during the succeeding decade can be said to have engrossed the attention of responsible authorities as the one relating to the rehabilitation of that tottering system. Although the controversy as to the proper line of reconstruction to be adopted was long drawn out, the causes of the collapse were so patent that all those who had anything to do with Indian Finance unmistakably laid their finger on one supreme defect in the system whose breakdown they had witnessed, namely, the irresponsible extravagance it engendered in the Provincial Governments. To obviate this evil it was sought on the one hand by some responsible authorities

" to make the Local Governments partners in the great joint stock of Indian Finances, and, so to enlist their interest and animated co-operation with the

Government of India, instead of keeping them on the footing of agents and servants, who, having no motive for economy and using the means of their masters, think only of enhancing their own demands by comparisons more or less well founded, with the indulgence conceded to others."

This view gradually led to the formation of a considerable body of well-trained opinion for changing united India into the United States of India, by making the provinces into separate and sovereign States. The aim was to substitute a Federal system for the Imperial system and to assimilate the financial position of the Central authority in India to that of the Central authority in the United States. For the consummation of the Federal plan it was urged that the revenues of India should not be dealt with as one income, collected into the Imperial Treasury and thence distributed among the different Provincial Governments. According to the plan each province was to be allowed to keep its revenues and meet its charges from them. The Central Government was to have its own separate resources and, if need be, supplemented by contributions from the provinces as their share of the expenditure of the Central Government based on some equitable standard. Thus under the Federal plan the consolidated Imperial Budget with its formal division between Imperial and Provincial was sought to be replaced by the creation of distinctly separate budgets, Central and Provincial, based on a genuine division of services and allocation of revenues.

Many advantages were claimed in favour of the Federal plan. First it was believed that the separation of the revenues and services would lead the ways and means of the Central as well as of the Provincial Governments to be clearly defined, so that each one of them would be responsible for administering its affairs within the funds allotted to it. Heretofore the Provincial Governments sent up their estimates of revenue and expenditure as returns unconnected with each other, and the task of balancing them was left to be done by the Supreme Government upon the aggregate of the different provincial estimates submitted to it. Under the Federal plan the provincial estimates would have to be balanced accounts of receipts and charges made over to them. Though primary it was not the only advantage which the Federalists claimed for their plan, for it was advanced not only as a measure to set bounds to the extravagant expenditure of the Local Governments by limiting the funds on which they were to draw, but also as a measure for setting bounds to the growing expenditure of the Central Government as well. The Federalists did not conceal the fact that the Central Government, being in a position to draw upon the total resources of India as a whole, was inclined to be extravagant in its own expenditure. They therefore thought that the Federal plan, involving as it did the allocation of revenues and services, would result in enforcing economy on the Central as well as on the Provincial Government.

The Federal plan was not only proposed by its advocates in the interests of

economy and responsibility, but also in the interests of plenty. The Federalists denied that India offered few sources of revenue for the growing expenditure of the State. Though the Indian Finance ferry was water-logged, it was their view that there were many sources of taxation with the outpourings of which it could be set afloat. But they argued that these available sources were left untapped, as the Imperial Government, which could tap them, would not do so because of their restricted *locale*, and Provincial Government, which would like to tap them, because of their restricted *locale* could not do so under the existing constitutional law. But if the Provincial Governments were vested or rather re-vested with the powers of taxation as they would be under the Federal plan, such sources of taxation as were given up for being too regional-in character by the Imperial Government would be used by the Provincial Government to the great relief of Indian Finance as a whole.

Not only was Federalism advocated in the interests of economy and plenty, but also in the interests of equity. It was contended that the existing system resulted in an iniquitous treatment of the different provinces. If we take public works of provincial utility and the expenditure incurred upon them in the different provinces as the criterion, the criticism of the Federalists cannot be said to have been unfounded. On the other hand, the following figures go to substantiate a very large part of their arguments :—

OUTLAY ON PUBLIC WORKS

Average for the years 1937-8 to 1845-6

Province	Population in thousands	Area in sq. miles	Revenues in hundreds of Rs.	Expenditure on Public works in hundreds of Rs.
Bengal	40,000,000	1,65,443	10,239,500	1,79,812
N.W. P.	23,200,000	71,985	5,699,200	1,41,450
Madras	22,000,000	1,45,000	5,069,500	30,300

Compiled from *Calcutta Review*, 1851, Vol. XVI, p. 466.

Thus the outlay on public works was in Bengal 1 3/4 per cent.; in North-Western Provinces, 2 1/2 per cent.; and in Madras a little over 1/2 per cent./of their respective revenues. This favoured treatment of some provinces as against the others was justified by the Imperial Government, which distributed the funds, on the ground that the favoured provinces showed surpluses in their accounts. But the Federalists pointed out these deficits and surpluses ascribed to the different provinces were grossly fictitious. They were the result of a bad system of accounts. The system was bad for the reason that it continued to show the accounts of the financial transactions of the country not according to Heads of Account but according to the provinces in which they occurred as used to be the case before 1833 when there was no common system of finance. With the passing of the Act of 1833 this system of accounts had become quite out of

keeping with the spirit and letter of that Act. This would not have mattered very much if the All-India items were separated from the purely provincial items in the General Heads of Account. In the absence of this the evils of the system were aggravated by entering exclusively into the accounts of a province the charges for what was really an All-India Service, so that it continued to show deficits, while others which escaped continued to show surpluses and claim in consequence the favoured treatment given to them. The Presidency of Bombay offered to the Federalists a case in point. The demands of the Presidency were invariably received with scant courtesy by the Government of India, for in its history Bombay seldom showed any surplus in her accounts. But, if it had been realised that the deficits were caused by the barbarous system of accounts which kept on charging the Presidency with the cost of the Indian Navy, it undoubtedly would have fared better. Such vicious ways of appointment were not the only evil features of the system of accounts. Under it it was quite common to charge one Presidency with the cost of a service and to credit another with the receipts thereof. How the deficits found in the Madras accounts were inflicted upon it by the erroneous system of accounts may be seen from the following :—

Cost of the Army of Occupation		Revenues derived from the Occupied territory	
Debited to	Amount Rs.	Credited to	Amount Rs.
Madras	79,83,000	Bombay	20,00,000
		Bengal	1,04,22,870

Taking into consideration the iniquities involved in such a system of accounts, it is beyond dispute that the advantage claimed by the Federalists for their plan was neither fictitious nor petty. A division of functions between the Federal and Provincial Governments would have in itself been an advantage by comparison with the existing chaos. And, if it did not result in equity, it had at least the merit of opening a way for it.

When however the Federal plan was put before the authorities in the form of a practical proposal, it gave rise to a determined opposition. The challenge was at once taken up by the supporters of the Imperial system who, be it noted, were mostly military men in civil employ. They opened their attack on the Federal plan from two sides, that of practicability and expediency.

Is it possible, asked the Imperialists, to localise the revenues and charges of India as belonging distinctively to one particular province? They insisted that

"from the commencement of (the British) power (in India)..... the interests and affairs of (the) presidencies and the provinces have been interwoven and interlaced—one often overlapping the other, and vice versa—in a manner from which extrication or disentanglement is now impossible, without making

changes which would entail inconveniences greater than any entailed by the existing system..... The army of Bengal Presidency is quartered not in the rich districts of the Lower Ganges, but mainly in the poorer districts of the Punjab. Thus placed, that army defends virtually the whole Presidency. The Madras army is not kept within that Presidency, but holds, besides the Madras country, the Deccan, the Central Provinces, and British Burma. Similarly the Bombay army holds, besides its own Presidency, the State of Rajputana and of Malwa. The Lower Provinces or Bengal proper are in themselves rich; but besides their own revenues they receive large customs receipts, which belong partly to them, but largely also to the other Divisions of the Bengal Presidency. Even Bengal opium does not entirely belong to Bengal, a large portion being raised in the North-Western provinces. In Bombay the opium revenue does not, strictly speaking, belong to that Presidency at all, being raised beyond its limits, in the territories which, if included in any Presidency at all, would pertain to that of Bengal. Some of the Salt Duties, both of Madras and of Bombay, are raised on salt destined for consumption in Central India, and, in strictness, should be credited to the Government of India. Instances might be multiplied; but it becomes instantly evident that, if an adjustment of these matters with a view to complete localisation of finance were to be attempted, many difficulties, perhaps even disputes, would arise..... "

Arguing in the same strain, Lord Lawrence, the then Viceroy of India, wrote:

" Experience has shown that it is convenient that the resources of British India should be considered in the aggregate and not with reference to the particular province in which it is raised. If the rule were otherwise, we must enter into the question—what are the revenues which each province may fairly claim? What are the items of expenditure which may justly be charged to each? Is the Punjab, for instance, to be charged for all the British troops located in the hills for sanitary considerations ? Is the whole of the force ranged against the Northwestern border to be similarly debited ? Are the troops quartered in Rajputana to be charged to the Bombay Presidency to which they belong, or in what manner is their cost to be arranged for ? On the other hand, we may be asked, why should not Bengal in particular—which, having no foreign neighbours, and a docile and timid population, requires only a minimum garrison—have the benefit of her surplus revenues ? Why on the opposite view of the question should not Bengal bear her share of the cost of the troops located in the North-Western Provinces, the Punjab and Central India, which guard her from such invasions as those of the Rohillas, the Mahrattas and the Pindarics of former times? These are all questions which would require solution if each were to have a financial system of its own."

and in his opinion the question was impossible of solution.

But the Imperialists went further than this and argued that, even if it were possible to distinguish and localise the charges and the revenues into provincial and central, it was inexpedient to do so. Under the existing system of finance, they held that

" the Imperial Government, disposing of financial resources of the whole of India, can carry those resources at once where they are most needed. There are objects which have a truly national importance, though they may appear chiefly beneficial to a particular district. There may be evils, necessities and dangers in particular districts, which it is the duty of the supreme Government to correct and remedy at the charge of the whole. The creation or improvement of a part may have a national importance, though the expenditure on it may seem unfairly beneficial to a particular locality. A road, a canal, a railway from a cotton district or a coffee district, or a tea district, may have a vital significance to the whole people and commerce of India ; and yet the expenditure on such a work be out of all proportion to the present revenue of the district which it is destined to develop..... or the supreme Government may find it necessary to lay out, for moral and social purposes, larger sums on recently conquered, savage, or dissatisfied provinces than the revenues of those provinces seemed to warrant, in order to remove causes of disturbances or dangers, and to force those provinces into some degree of harmony with the long settled, pacified, reclaimed portions of the Empire..... The old provinces of the Empire conquer the new provinces. The old are bound in duty to civilise what they conquer. We have no right to annex a country and then throw it on its own resources. Conquest has its own duties as well as its rights."

" I venture to demur," wrote Lord Napier of Merchiston, President of the Council of Madras, " to the policy of those who would restrict the benefits of the supreme Government to its receipts, and who would measure out in a parochial spirit to every province appropriations proportional to its specific returns. On the contrary, it ought to be a satisfaction to the rich to help the poor; to the old to protect the young; to the good to improve the bad; for thus all can co-operate in building up the glorious fabric of a—United India. Such ends can only be attained by a Central Government disposing of the financial resources of a whole Empire

It is evident that arguments or sermons such as the above by themselves could never have supported the cause of the Imperialists. Notwithstanding the emphasis laid upon the difficulty of separating the revenues and charges into Imperial and Provincial, it must be conceded that the task was by no means so insuperable as the Imperialists made it out to be. The difficulty of apportioning the military charges could have been easily obviated by centralising the military and making it a charge of the Central Government. On the same basis all those services charged to a particular Presidency or Province, but which from their

nature benefited the whole Empire, could have been easily incorporated into the budget of the Central Government. Similarly it was possible in practice to allocate the existing sources of revenue between the Central and the Local Governments. The Central Government could have been allowed to retain for its use such sources of revenue the *locale* of which extended beyond the limits of a Presidency or the maximum yield of which depended upon a uniform administration of the same throughout the country. While on the other hand the Provincial Government could have been allowed to appropriate such sources which were restricted in their *locale* or the yield of which depended upon local vigilance. For instance, the customs duties could have been easily made a central resource, not only because their incidence was wider, but because they required a common and uniform policy of legislation and administration. The opium revenue could have been treated as a central source of revenue, and the same treatment could have been granted to the salt revenue. Of course it would have been difficult to effect a separation of the sources of revenue in such a way as would have granted to each of the several Governments concerned resources adequate to meet the charges devolving upon them. A certain adjustment of funds by contributions from the provinces to the Central Government or from the Central Government to the provinces would have been inevitable; neither could it have been possible to obviate the adoption of principles more or less arbitrary in the matter of apportionment of revenues or of charges. But admitting the difficulties and arbitrariness involved in the problem of separating the Imperial Budget into a Central and several Provincial Budgets, it must still be said that it was quite capable of satisfactory solution. Colonel Chesney in response to the challenge thrown out by the Imperialists had made a notable attempt to distinguish the existing heads of charges into Imperial and Provincial. In his *Indian Polity* he says :

"The items of Imperial expenditure for which contributions would be required consist apparently of—(1) the Home Establishment and charges disbursed by the Secretary of State ; (2) interest on Indian debt; (3) Establishments of the Government of India ; (4) Diplomatic establishment ; (5) Army ; (6) Imperial Services—Post Office and Telegraph Department ; (7) interest guaranteed on railway capital ; to which must be added (8) grants in aid to some of the poorer provinces (which do not at present pay their expenses)."

This and other efforts convinced the Imperialists that their argument from practicability was bound to fail. Consequently they shifted their emphasis from the argument from practicability to that from expediency. Expediency furnished a better ground for attacking the Federal plan. Can a Federal Government be as efficient as the Imperial Government? Can its credit be as high? Can its prestige be as great as that of the existing Imperial system? It must be premised that it was fresh in the minds of the people that it was the Imperial system with a strong

power of control that had saved the country to the British from the hands of the mutineers of 1857. The survival value of the Imperial system had been proved in the struggle. By a clever maneuver the Imperialists turned to the authorities and asked them to consider what had sustained the Imperial system throughout the struggle. They did not fail to emphasise the point that it was because the Imperial system of finance had given into the hands of the Imperial Government the control over the management of the revenues and disbursements of the Empire that the latter, in an emergency like the Mutiny, could stimulate every source of income, close every avenue of outlet, and concentrate all its expenditure on the capital object at stake— the energetic prosecution of hostilities. They showed that, without the Imperial system of finance, the Imperial Government would have had to deal with lukewarm, reluctant, hesitating or even hostile partners, perhaps not directly concerned in the struggle or convinced of its necessity, and solicitous for exoneration or delay. Further they made out that the Imperial management of finance was vital not only in heightening the efficiency of government, but also in maintaining the high state of credit. Credit, it was argued, depended upon the magnitude of the revenue, and to disintegrate the revenues was tantamount to lowering the credit. The Federal plan was also accused of abrogating the European tradition which has given prestige a very high place in its code for Asian government. It was inconceivable to the Imperialists that the Central Government could maintain its prestige without centralisation in finance, for it was the system of Imperial Finance which, having collected the leading strings in political and administrative matters into the hands of the Imperial Government, enabled that Government to dictate a policy and have it executed to its own satisfaction. But who could uphold the prestige of the Central Government, if it became a pensioner of the Local Governments subordinate to it?

Looked at from the vantage ground of detachment from the time of the controversy one may wonder what strength there was in the argument from expediency which gave the Imperialists such an easy victory over the Federalists. Federal Governments such as those existing in America, Germany or elsewhere do not lend support to the view that in their working there is bound to be a loss of efficiency, credit, or prestige. Their history has belied all these gloomy foreboding. But it should be remembered that at the time the controversy raged in India, much of the history of Federalism was a blank page, for Federalism was itself in its infancy. People, however, sided with the Imperialists, not because they could not draw upon the history of Federalism for arguments in its favour, but because the events of the time had inclined them to support the Imperial system. The Imperial system had saved India from the hands of the Mutiny of 1857, and when their fears of its repetition were not yet allayed it was too soon to expect them to consent to disrupt a machine that had just then proved its worth in the great contest. Conscious though they were of its defects,

people recoiled from any attempt to tamper with it. So strong was the partiality of the people for the Imperial system that, notwithstanding the many defects which to their knowledge detracted from the efficiency of the system, they could give a sympathetic hearing to the Hon'ble Major-General Sir H. M. Durand, who wrote:

" I assert confidently that at present there is absolutely no ground whatever for the allegation that the financial control of the Government of India goes to undue lengths in what it attempts, and miscarries miserably. On the contrary, any partial miscarriage of control is no proof whatever that the rules are faulty, but that their relaxation is highly inexpedient, and that more rigid subordination of them should be enforced both by the Government of India and the Home Government. To subvert the financial control of the Central Government because one out of nine administrations has proved rather refractory, is about as sensible a procedure, to my mind, as to annul the articles of War and the powers of the Commander-in-Chief because a regiment should somewhat happen to misbehave. I venture to doubt the statesmanship of ruling either India or armies in this way."

Notwithstanding the victory of the Imperialists, it must be said the Federalists lost a cause which was bound to succeed. For the sentiment of the time, however favourable to the retention of the Imperial system, was powerless to resist the force of events. The Imperial Government had to be extricated from the state of chronic penury in which it had fallen, and if statesmanship did not favour the system of Federal Finance as a means, financiers soon learnt that the system of Imperial Finance was doubtful as an end.

CHAPTER III

THE COMPROMISE

IMPERIAL FINANCE WITHOUT IMPERIAL MANAGEMENT

If the Federalists failed to carry the day, they at least led their opponents to improve the system by removing some of the most radical defects from which it suffered. Attention was mainly directed towards revising the revenue laws and improving the machinery of control so that more revenues be obtained and less wastefully spent. With the primary object of making the Imperial system strong and prosperous, serious attempts were made about the close of the rule of the East India Company to do away with the oppressive taxes which had so long retarded the prosperity of the people and consequently of the Government. The internal custom duties were done away with, and the country was not only freed from all restrictions which hampered the growth of trade and industry, but positive encouragement was given to them by introducing the element of protection in the import tariff and trade was facilitated by equalising the duties on English and foreign shipping. Articles of export were also relieved from the handicap of export duties and efforts were made to improve the cultivation and pressing of cotton, tea and other staples which commanded a great market in Europe and

elsewhere.

The administrative machinery was next subjected to revision. Advantage was taken of the Indian Councils Act of 1861 authorising the Viceroy " to make from time to time rules and orders for the more convenient transaction of business in his Council," to bring legally to an end the system under which the whole Council was supposed to take part collectively in the disposal of all the business of the Government by assigning to each member of the Council the charge of a separate department of administration: the Council was thus virtually converted into a Cabinet of which the Governor-General became the head. In this manner a place for a Chancellor of the Exchequer was created to which was appointed the well-known financier, Mr. James Wilson. The attention of Mr. Wilson was directed first of all to the improvements in the machinery of fiscal administration. The credit of establishing in India a uniform system of accounts, centralisation of civil and military audit, and the introduction of an appropriation budget, rightly belongs to him. With the improvement in the revenue laws and the check on waste through improved and efficient administration was combined the policy of retrenchment in expenditure, and the budget and audit rules were

" so framed as to leave to the head of each Local Government or of each branch of administration a much larger (*sic*) discretionary power than.....heretofore..... allowed in rearranging the details of expenditure"

if that led to retrenchment. So drastic was the economy practised that, soon after the inauguration of the policy of spreading education throughout the country initiated by the dispatch of the Secretary of State in 1854, a stop was put to any increase of expenditure on education.

But notwithstanding all these efforts at betterment howsoever diligently sustained, they did not improve the finances of India materially; at any rate. Mr. Wilson in his Financial Statement for 1860-1, by way of summing up the financial situation, said:

" we have a deficit in the last three years of £ 30,547,488; we have a prospective deficit in the next year of £ 6,500,000; we have already added to our debt £ 38,410,755." To meet this huge deficit Mr. Wilson was obliged to augment the stamp duties, double the external customs, and impose an income tax, hitherto unknown to the people. Even the yield of these " three tremendous taxes " did not help Mr. Samuel Laing, the successor of Mr. Wilson, to a prosperous condition, for he too in his Financial Statement for 1861-2 wanted £ 500,000 fairly to weather his deficit and get into smooth waters with a small surplus. A few years of financial prosperity intervened. But Mr. Massey, who relieved Mr. Laing in 1866,

" upon a review of the financial condition of the Empire and the increasing demands made upon its resources..... deemed it expedient to make provision for a permanent addition of a million sterling at the least to the existing revenue"

Why the efforts of these successive Finance Ministers were not crowned with success is to be explained chiefly by the fact that the administrative and public needs of the country had grown beyond measure. After the Mutiny

"thousands of Englishmen, not only soldiers, but Englishmen of almost every class, poured into India. Ten thousand things were demanded which India had not got, but which it was felt must be provided. The country (had to be) covered with railways and telegraphs, roads and bridges. Canals (had to be) made to preserve the people from starvation. Barracks (had to be) built for a great European army, and every sort of sanitary arrangement which would benefit the troops (had to be) carried out. This was not only true in regard to matters of Imperial concern. Demands for improvements similar to those which fell upon the Central Government cropped up in every town and in every district controlled by the Local Government. The demands for improved administration also made themselves effective. The police was in a shameful condition throughout India and the inadequacy of the pay given to native judges and other subordinate officers employed in the posts of importance in the courts was declared by Lord Lawrence when he was Viceroy to be a public scandal. Among more than four thousand of these officers in the Bengal Presidency, the highest paid of all, and these were very few, received £180 a year. The great majority received from £12 to £24 a year sums less than those earned in many parts of India by common bricklayers and carpenters. All these had to be put on a completely new footing.

While the needs for expenditure were thus growing, economy in expenditure became difficult of achievement. Comparatively easy at first, each successive measure of economy became directly, as well as relatively, more arduous than its predecessor. The growing needs of improvements, hitherto neglected, and the contracting scope for economy, combined to demand an ever-increasing scale of taxation. The dangers of increased taxation by an alien Government of a people not interested in obtaining the amenities of life, much less at the cost of a tax, were uppermost in the minds of the three great financiers who were sent out from England in succession to rehabilitate the finances of India on a sound and stable basis. They realised that unless bounds were set to these demands for improved administration and improved material and moral conditions, the immediate benefits of which were enjoyed more by the European than the native population, taxation howsoever high would be inadequate for financial solvency, besides being dangerous to the political stability of the Empire. Under the existing system of barren uniformity and pedantic centralisation their object was thought to be impossible of achievement; for the Local Governments, on which alone the Central Government could depend for economy, rendered at best to that Government not only a cold and languid support in financial vigilance and reform, but too often exhibited a passive resistance, and even countenanced evasions of

regulations intended to be conducive to economy. The only way to make Local Governments economical in their ways was to give them the power and responsibility of managing their own affairs. As a matter of administrative experience the financiers had found that while some of the branches of revenue and expenditure were truly imperial, there was a wide field of both of them which was properly local in character, and ought to have been entrusted to Local Governments. They were convinced that there could be no standard of economy until the requirements of the Local Government were made absolutely dependent upon known means, and nothing they thought would serve to make known to the Local Governments the means available for their outlay than to carve out from the Imperial purse a separate purse of definite magnitude for the use of Local Governments and to throw on them the responsibility of meeting their demands and maintaining an equilibrium in their finance. Thus they were led to the same conclusion as the Federalists. However, to make the plan acceptable to the Imperialists, they made certain concessions without seriously compromising the working of the plan. The Federal plan required a change in the constitution of the system of government in India. It necessitated a *legal* partition of the revenues and charges of India between the Central and the several Provincial Governments. While all, including the Imperialists, recognised in the Federal plan a powerful measure for enforcing financial responsibility and economy, the chief objection to it arose from the fact that it sought *legally and permanently* to divest the Central Government of the resources of India. The financiers as practical politicians soon found out a way to obviate this defect in the Federal plan. By virtue of their experiences of the working of the British Parliament they found that there was no necessity to resort to a constitutional change. Convention was deemed to be as good as law and, once established, can seldom be altered without disturbance. Separation of charges and revenues between the Central and Provincial Governments was therefore proposed to be made a matter of convention which could be upheld so long as it was profitable for the parties concerned to do so. This gave all the advantages of the Federal plan without legally divesting the Central Government of its control over the resources of India. In its nature it was a compromise between constitutional Imperialism and constitutional Federalism. It meant Imperial finance without Imperial management. Under the compromise the revenues and charges remained Imperial in their status, but their management was to be provincialised, so that each of the Provincial Governments was given to administer a part of the Imperial charges incurred in its territory within the limits of a part of the Imperial revenues collected within its territory. This was the essence of the new plan. It differed from the Federal plan in retaining to the Imperial Government the supreme controlling, counselling and regulating authority in all matters pertaining to Indian Finance, without its being actually engaged in the details of the

administration of a *part* thereof.

In the essence of the plan as described above all the three finance ministers who were called upon to undertake the task of reconstruction had agreed. They differed, however, in the scale on which it was to be carried out. Whether Mr. Wilson had ever elaborated his own skeleton of the plan is doubtful; but that the idea of it had occurred to him seems pretty certain. The Income Tax Act XXXII of 1860, imposed by him

"was meant to consist of two parts—first, a variable tax, originally fixed at 3 per cent on incomes, which percentage it was intended should be raised or lowered as the general exigencies of the Empire required, and which might if the state of the finance should ever permit, be entirely remitted; and secondly, a permanent tax of 1 per cent., which was to be at the disposal of the local administration, and to be expended on roads, canals, and other reproductive public works, within the area which paid the tax (*vide* sections 190-4 of the Act). This portion of the tax was never intended to be remitted. It was always to be kept up, not only to meet the charges to which it was applicable, but in order to maintain the machinery of the tax so that at any moment of exigency, after a temporary remission the other portion of the tax, applicable in aid of the general finances, might be re-imposed without agitation, discussion, or trouble."

But, as Mr. Wilson did not live long enough to elaborate his ideas into a scheme, it is difficult to say to what extent he intended to work them out in practice.

Mr. Laing, the successor of Mr. Wilson, put it in a much more definite shape. His budget for 1861-2 was for a deficit caused chiefly by the pressing demands of the Local Governments for useful public works, and his sense of financial safety compelled him

"to curtail roads, canals and other useful works of this description, to the allotment on which they (had) been carried on or rather..... starved, since the Mutiny."

But his anxiety to promote the useful public works, the urgency of which he fully recognised, led him to propose to the Provincial Governments a method of supplementing the scanty Imperial grants made to them. He said to them:

" Take what we are able to give you, and for the residue take certain powers of taxation and raise it yourself..for there are certain subjects which can be dealt with far better by local than by Imperial taxation..."

His object was to enact local budgets " not merely to meet a temporary difficulty but to inaugurate a permanent improvement," to the relief of the Imperial treasury and the benefit of the Provincial Governments. This scheme involving the management of the public works charges by the Local Government with an allotment from the Imperial revenues supplemented by the power to tax had

secured a general approval. But at the time when the scheme was put forward the Local Government was without the requisite machinery for carrying into execution the powers of legislation necessary to impose the taxes proposed to be given to them. The execution of the scheme had therefore to be postponed pending the enactment of local legislative councils then undertaken by Parliament. But, the ensuing years having been years of financial prosperity, the interest in the scheme relaxed and it was consequently dropped *sine die*.

This spell of prosperity, however, proved to be only a passing phase and the stress of returning adversity which beset Mr. Massey compelled him to revive the scheme in a much more enlarged form. He proposed that:

" In considering the ways and means by which the additional amount (of one million sterling) should be raised the most convenient mode of proceeding would be by a partial transfer of charges of a local character from Imperial to local account."

As the annual produce of local funds applicable to local purposes in India did not much exceed two million sterling, it was proposed to make the moderate addition to this amount of £1,200,000 in round numbers to be raised in rateable proportions in the several Presidencies and Local Governments, and applied in relief of a corresponding amount of charge for local services then borne by the Imperial revenues. The above-mentioned sum of £1,200,000 was arrived at by an assessment of 4 per cent on the estimated revenues of the several Local Governments (except Burma) for the current year, after excluding customs duties and the income tax. The heads of charges to which the proceeds of the new funds were applicable were (1) education, (2) police, (3) district jails, (4) public works, (5) repairs and maintenance of roads. The list of taxes suggested to provide ways and means included (1) a license tax on trades and professions, (2) a house tax, (3) an octroi duty in towns, and (4) a succession duty on lands which did not pay revenue. The Local Governments were to be left free, subject to the approval of the Government of India in Council, to select the particular tax most suited for being levied in their respective territories so as to yield the full amount required, after deducting the cost of collection, and spend the proceeds on the services mentioned above, on all or any of them, according to their discretion.

The replies of the Local Governments and administrations addressed in connection with this scheme, indicated a general agreement as to the practicability of such a transfer of charges being made and being met by new local taxation, though there was also a general disposition to object to the transfer of charges without a simultaneous transfer of revenue with which to meet the expenditure on them. Under the circumstances the Government of India agreed to reduce the expenditure to be transferred to the Local Governments to £ 800,000 and to transfer to them the proceeds of the license tax as a means for

making adequate provision for the same The favourable reception accorded to the scheme and the sympathetic criticism to which it was subjected led Mr. Massey to extend and modify it. In his exposition of the new and enlarged scheme Mr. Massey wrote:

" my first object has been to select, for the first series of charges to be transferred to local authorities, those items of expenditure which being least susceptible of control by the Government of India, give as a whole, an amount of such dimensions as will not be difficult to manage, and yet will be of sufficient importance to indicate that the measure is intended to be a reality, and a step towards the more complete transfer of the financial administration to the local government. Taking the civil estimates..... it seems to me, plainly, the most convenient method of proceeding to transfer a few entire grants or section of grants, in preference to selecting special items from several grants..... By adopting the plan..... no change whatever in the system of accounts will be called for; and the only alteration will be, that certain sections of the grants for various purposes, will be provided in a special manner. The only exception to this rule... is in dealing with a head ' Miscellaneous ' which..... is rather an incongruous collection of charges.

Among these will be retained, for transfer to local management, all those items which would reasonably be termed local.... and the residue.... could easily be classed under some of the other main heads of charge. The most important of the charges which I should propose to transfer is that for 'Jails' subordinate to ' Law and Justice,' which may... be taken in lump. The charges for ' Registration ' and ' Tulubana ' also under ' Law and Justice ' follow. These are met from special fees credited under the head of ' Law and Justice'. To set off against these charges, a transfer of the revenue under ' Law and Justice ' is also proposed... Under ' Education' the ' Miscellaneous ' charges are proposed to be transferred to the corresponding transfer of the revenue credited under ' Education'. Next follows the whole of the charges under ' Medical Services ' except the fixed ' Medical Establishments and Chemical Examiners'. The entire charge under ' Stationery and Printing ' is also taken. Under ' Police ' the charges met by contributions from local sources are transferred, including the Railway Police. Against this is set off the receipts under ' Police'. ' Besides the above it is proposed to transfer a portion of the charges, for the collection of the Land Revenue and of the Income Tax and License Tax, which... I have assumed as likely to be levied in future. It has been necessary to assign a sum sufficient to cover the general charges which would be transferred and the propriety of transferring a corresponding portion of the cost of collection seems apparent. Under the designation of charges of collection of the Land Revenue were not included the cost of the Revenue Survey or Settlement as they were exceptional and variable, though the charges under ' Allowances to Village Officers ' were

included.

* * * *

" The first and principal transfer of revenue will be a portion of the Land Revenue, which I propose to fix at 1/16th or one anna in the rupee. The same rate will govern the proportion of the charges for collection transferred.....

" The next item of revenue which I assume at one-fourth of the Income Tax and License Tax, which I shall suppose to be raised.

" It is next proposed to transfer the whole of the receipts under the following heads : (1) Law and Justice, (2) Police, (3) Education, (4) Miscellaneous, except items of a financial nature, and also (5) all income under Police Works excepting that derived from Irrigation. The items of expenditure under Public Works proposed to be transferred are (1) Roads, (2) Repairs of Civil Buildings, (3) Miscellaneous works both new and repairs, and (4) Tools and Plant."

The scheme thus enlarged was discussed at length from various points of view. But though it won the approval of cautious critics the scheme was too large for the Imperialists. And as the two greatest of them, Lord Lawrence, the Viceroy of India, and Lord Napier of Merchistoun, Governor of Madras, disapproved of it, it failed to materialise in consequence of their opposition.

But unfortunately for the Imperialists, throughout this decade during which they were stubbornly objecting to any surgical operation on their patient—the Imperial system of Finance—it did not show any sign of convalescence. On the other hand, the delay in the operation aggravated its ills. Notwithstanding the constant enhancement in taxation and the reduction in expenditure, the three Chancellors of the Indian Exchequer sent from England could point to only three years of surplus during the decade between 1860 to 1870. On the other hand, to the embarrassments due to constant deficits was added the bewildering breakdown of the budget system created to bring about order and economy in the public finances of the country. Not to speak of its efficiency as an instrument of economy, the budget system under the strain due to excessive centralisation proved useless even as an instrument of order. The finances fell into a chaos. Notwithstanding the elaborate circulars and orders issued with regard to the accuracy in the framing of the budget estimates, it was an extraordinary phenomenon which confronted the Finance Ministers when the budgets, which were begun with large estimated surpluses, strangely enough closed with large actual deficits.

To what extent the actuals erred from the estimates may be seen from the following table:

Year	Estimate	ACTUAL
	DEFICIT-SURPLUS	DEFICIT-SURPLUS

1866-67	-66,700	-2,307,700
1867-68 ...	1,628,522	-923,720
1868-69 ...	1,893,508	2,542,861
1869-70 ...	48,263	1,650,000(est)

From the above table it is clear that the estimates for 1868-9 and for 1869-70, which were based on the revised estimates of 1868-69, were expected to end with an estimated surplus of £1,893,508 and £48,263 respectively. But when the actuals of the year 1868-69 showed that instead of a surplus there was to be a large deficit, Lord Mayo, who was in the meantime appointed to the Viceroyalty of India, became convinced that if his budget was recast on the basis of these results, it would close with an actual deficit instead of the estimated surplus. This financial surprise threw his budget into confusion, and to restore order he was obliged to adopt the unusual procedure of addition to taxation and the reduction of expenditure in the midst of the fiscal year.

The following is a synopsis of the measures he adopted :—

I. Additional Taxation—	£	
(1) Income Tax raised from 1 to 2 1/2 per cent.		320,000
(2) Enhanced Salt Duty (in Madras and Bombay)		180,000

Total 500,000

II. Total Reduction of Expenditure—

(1) Education		350,000
(2) Public Works	800,000	
Total	1,150,000	

Estimated Deficit 1,650,000

So grave was the crisis that with all these measures he could do nothing more than close his budget with an estimated deficit of £1,650,000 which would have been inevitable had it not been for certain windfalls such as the recovery of the value of supplies in the Abyssinian War and the adjustment of other large outstanding accounts which enabled him to convert his large deficit into a small surplus. Happy as he was over the immediate results of his efforts, Lord Mayo was convinced that there was something rotten in the system of Imperial Finance and, while anxious not to end it, he courageously set forth to mend it by inaugurating the scheme of Provincial Finance represented by the compromise the growth of which will be the subject-matter of Part II of this study.